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No. 243

IN THE

Supreme Court of the United States

OCTOBER TERM, 1939.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

v.

F. W. FITCH.

BRIEF FOR THE RESPONDENT IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

JOHN B. CLAYTON STIVER,
Counsel for Respondent.

ARNOLD F. SCHAETZLE,
Of Counsel.

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CITATIONS.

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BRIEF FOR THE RESPONDENT IN OPPOSITION.

Opinions Below.

The memorandum opinion of the Board of Tax Appeals is not reported. (R. 10-13). The opinion of the Circuit Court of Appeals for the Eighth Circuit is reported in 103 F. (2d) 702.

Jurisdiction.

The jurisdiction of this Court has been invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, c. 229 (43 Stat. 938) (28 U. S. C. A. #347). The judgment of the Circuit Court of Appeals was entered April 29, 1939.

Question Presented.

Whether this Court's decision in *Douglas v. Willcuts*, 296 U. S. 1, requires the taxation to the respondent of the income of an irrevocable trust which he established for the benefit of his former wife, although the respondent was not under any obligation to her which continued into the tax year and which was satisfied *pro tanto* by the distribution of trust income to her.

Statutes Involved.

The applicable statutes are set out in the Appendix, *infra*, pp. 9, 10, 11.

ARGUMENT.

I.

Douglas v. Willcuts, 296 U. S. 1, is not applicable.

In holding that the grantor of an irrevocable trust was taxable upon the income paid to his former wife, this Court, in *Douglas v. Willcuts*, 296 U. S. 1, pointed out that the taxpayer was under a legal obligation to his former wife in the tax year in question and that the income of the trust was used to satisfy that obligation. The opinion of this Court shows that the obligation of the taxpayer arose out of (1) his voluntary agreement to see that his former wife received a fixed amount per annum; (2) the provisions of the divorce decree which actually directed him to pay the fixed amount to his former wife; and (3) the general law of Minnesota under which the court granting the divorce retains the power to revise both the decree and the agreement between the taxpayer and his former wife.

In so holding, the Court recognized an exception to the statutory scheme relating to the taxation of trust income

which provides that the distributable income shall be taxed to the distributee and accumulated income shall be taxed to the trust. Sections 161 and 162 Rev. Act 1932, *infra* p. 10. The exception thus recognized is sound because otherwise a debtor could evade income taxes by the device of creating trusts with directions to apply the income to pay his obligations. The fact that the obligation is one for alimony or support is not crucial. The principle is the same whatever may have been the origin or nature of the obligation. The fundamental question is whether there is a continuing obligation of the taxpayer to which the trust income is being applied.

Where the grantor does not assume a continuing obligation to his former wife and where his liability to her for support and maintenance is extinguished upon the creation of a trust so that neither by contract nor the applicable state law is there, or can there be, any further obligation on him, the reason for the Court made exception to the statutory scheme fails. The mere fact that the trust grantor was originally under some obligation to the beneficiary, which obligation was extinguished once and for all by the creation of the trust, is not ground for attributing the subsequent income of the trust to the grantor. In such case the grantor derives no benefit from the trust income which concerns him no more than the subsequently accruing income of property transferred absolutely in payment of a debt concerns its former owner. Thus, a distinction must be made between the case in which the grantor's liability to his former wife is extinguished upon the creation of the trust and the case in which the grantor's continuing obligation is satisfied from time to time by the application of the trust income.

Douglas v. Willcuts, supra, has no application to a case where all obligation of the grantor to his former wife is extinguished by the creation of a trust and neither by local law nor by contract is there any obligation on the grantor

to supplement the trust income or any power in the courts to revise the arrangement. In such case the income is that of the beneficiary taxable to her, at least where, as in this case, the trust is irrevocable and the grantor has retained no reversionary interest in the trust estate. The situation is the same as if a lump sum had been paid to extinguish finally the obligation to support. As this Court said of the analogous situation in *Helvering v. Butterworth*, 290 U. S. 365, the grantor's former wife has seen fit to exchange her marital rights for the position of a true trust income beneficiary and there is no reason why she should not be treated as such for tax purposes.

II.

The Second, Sixth and Eighth Circuit Courts of Appeal agree that if the taxpayer is not under a legal liability to his former wife in the tax year in question the income of an irrevocable trust created by him is not taxable to him and there are no Court decisions to the contrary.

The Sixth Circuit Court of Appeals in *Commissioner v. Tuttle*, 89 F. (2d) 112, and the Second Circuit Court of Appeals in *Helvering v. Leonard*, ... Fed. (2d) ..., and *Fuller v. Helvering*, ... Fed. (2d) ...[1], have considered the precise question involved here and decided the question unanimously in accord with the decision of the Eighth Circuit Court of Appeals in the instant case. Indeed, the petitioner does not assert any conflict, but attempts to show that there is some confusion and uncertainty in the cases.

As a matter of fact, the decided cases are all in accord with the principles stated above. The only confusion appears to exist in the Department of Justice which after successfully opposing *certiorari* in *Alsop v. Helvering*, 302 U. S.

[1] These cases decided by Second Circuit Court of Appeals on June 30, 1939, not yet reported at time of printing this brief. Same are set out in full in appendix B commencing page 18 of the petition herein.

767, and *Donnelley v. Helvering*, 101 F. (2d) 879, cert. den. June 5, 1939, on the ground that the decisions in *Commissioner v. Tuttle*, 89 F. (2d) 112, and the instant case were distinguishable because the trust grantors were not under any continuing obligation to the beneficiaries which was satisfied by the application thereto of the trust income, now asserts that those decisions are wrong and that no such distinction should be recognized.[2] (See Brief in Opposition in *Alsop* case, p. 9;)

In every case in which the trust grantor has been held taxable on trust income on the authority of *Douglas v. Willcuts*, it has appeared that he was under a continuing legal obligation which was satisfied *pro tanto* by the application of the trust income in the particular tax year involved. In *Helvering v. Lucy Blumenthal*, 296 U. S. 552, the grantor remained personally liable for the bank loan to the satisfaction of which the trust income was to be devoted. In *Helvering v. Schweitzer*, 296 U. S. 551, and *Helvering v. Stokes*, 296 U. S. 551, the grantor remained legally liable for the support of the minor children despite the creation of the trust. In *Commissioner v. Hyde*, 82 F. (2d) 174; *Glendinning v. Commissioner*, 97 F. (2d) 51; *Alsop v. Commissioner*, 92 F. (2d) 148, cert. den. 302 U. S. 767, and *Donnelley v. Helvering*, *supra*, the grantors remained liable by force of their express agreements to make up deficiencies in trust income, so that their former wives would receive a fixed amount in each year. In *Helvering v. Coxey*, 297 U. S. 694, the grantor re-

[2] At page 4 of the Government's Brief in opposition to certiorari in the *Donnelley* case it was stated:

"*Blair v. Commissioner*, 300 U. S. 5, *Commissioner v. Tuttle*, 89 F. (2d) 112 (C. C. A. 6th), and *Fitch v. Commissioner*, 1939, Prentice-Hall Federal Tax Service, vol. 1, par. 5,398, decided April 25, 1939 (C. C. A. 8th), are all distinguishable from the present case on the ground that the application of the income in question in those cases arose from an outright transfer of property or income, with no obligation to maintain future payments of income, and thus was not in discharge of a continuing obligation of the taxpayer, as in the present case. See *Alsop v. Commissioner*, *supra*, where a conflict with the *Tuttle* case, *supra*, was asserted in the petition for certiorari."

mained liable, as was pointed out in the Government's petition for certiorari (p. 6), under the law of New Jersey, which imposed on him an obligation to support his wife even after divorce and despite the assignment which he had made for her benefit.

The petitioner attempts to dismiss as a mere technicality, without significance, the circumstance that every case considering this question has turned one way or the other, depending upon whether or not the trust grantor's liability continued into the tax year involved. However, this distinction has been fully considered by the courts, and every court considering the question has followed it. These cases establish the fact that the fundamental question is whether there is a continuing obligation of the grantor, after the trust is created, so that the trust income continues to be constructively the grantor's, used from time to time to pay his obligations.

III.

The Respondent was not under any liability to his former wife in the tax year involved.

The respondent in the instant case did not agree to pay his former wife a fixed amount each year, but merely agreed to create a trust for her benefit and to transfer certain property to her. Upon the creation of the trust and the transfer of the property referred to in the agreement, the petitioner's obligation under the agreement was completely discharged. The decree granting the petitioner's former wife an absolute divorce did not impose any obligation on him to pay her alimony or any amount in lieu thereof, but merely ratified and confirmed the agreement and the property and alimony settlement made by the taxpayer and his former wife. Thus the obligation imposed on the petitioner by the decree was extinguished by the cre-

ation of the trust and the transfer of the property referred to in the agreement.

Nor was there any obligation upon the petitioner, under the law of Iowa, to support his former wife after the final decree of divorce was entered. The law of Iowa is well settled that after a final decree of divorce which contains no provision as to alimony, or which is coupled with a lump sum settlement between the parties, there is no obligation on the husband to support his former wife. This proposition was recognized by the court below and is supported by the cases cited in the opinion. *Kraft v. Kraft*, 193 Iowa 602, 187 N. W. 449; *Spain v. Spain*, 177 Iowa 249, 158 N. W. 529; *Carr v. Carr*, 185 Iowa 1205, 171 N. W. 785; *Barish v. Barish*, 190 Iowa 1493, 180 N. W. 724; *McCoy v. McCoy*, 191 Iowa 973, 183 N. W. 377. The cases referred to in the footnote on page 10 of the petition herein follow the decisions in the above mentioned cases and are further authority in support of the proposition that the respondent was under no liability to his former wife after the entry of the final decree of divorce. In *McNary v. McNary*, 206 Iowa 942, and *Goldsberry v. Goldsberry*, 217 Iowa 750, the court held that a final decree of divorce would not be reopened and modified. *Handsaker v. Handsaker*, 223 Iowa 462, merely holds that a final decree of divorce can be modified where the court granting a divorce specifically retains jurisdiction in the decree. It is clear therefore, as held by the Eighth Circuit Court of Appeals in the instant case, that the respondent was under no legal obligation to his former wife in the tax year involved.

Respondent had not voluntarily obligated himself to pay his former wife a fixed amount per year; the decree of divorce imposed no obligation on him to pay her fixed amounts as alimony or in lieu of alimony; and the court granting the divorce had no power after the entry of the decree of divorce by supplemental decree or otherwise to order him to pay any amount to her. Hence, since all of respondent's

obligation to his former wife had ceased prior to the tax year involved, *Douglas v. Willcuts, supra,* can have no application.

CONCLUSION.

THE DECISION OF THE COURT BELOW WAS CORRECT. THERE IS NO CONFLICT OF DECISIONS AND HENCE THE PETITION SHOULD BE DENIED.

Respectfully submitted,

JOHN B. CLAYTON STIVER,
Counsel for Petitioner.

APPENDIX.

Provisions of Revenue Act of 1932 Governing the Taxation of Trust Income.

SEC. 161. IMPOSITION OF TAX.

(a) APPLICATION OF TAX.—The taxes imposed by this title upon individuals shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) COMPUTATION AND PAYMENT.—The tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary, except as provided in section 166 (relating to revocable trusts) and section 167 (relating to income for benefit of the grantor). For return made by beneficiary, see section 142.

SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23(n) any part of the gross income, without limitation, which pursuant to the terms of the will or deed cre-

ating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23(n), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit;

(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under subsection (c) of this section in the same or any succeeding taxable year;

(c) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary.

SEC. 166. REVOCABLE TRUSTS.

Where at any time during the taxable year the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(a) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust for such taxable year shall be included in computing the net income of the grantor.

SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23(n), relating to the so-called "charitable contribution" deduction);

then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section, the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question".